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IN THE

Supreme Court of the United States

OCTOBER TERM, 1937. **No. 505.**

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

GEORGE W. ELKINS.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR THE RESPONDENT.

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George W. Elkins.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR THE RESPONDENT.

OPINIONS BELOW.

The Opinion of the United States Board of Tax Appeals (R. 87-100) is reported at 33 B. T. A. 127. The Opinion of the Circuit Court of Appeals (R. 387-392) is reported at 91 F. (2d) 534.

JURISDICTION.

The judgment of the Circuit Court of Appeals for the Third Circuit was entered July 21, 1937 (R. 392-393). The Petition for Certiorari was filed October 14, 1937, and was granted November 8, 1937. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

COUNTER-STATEMENT OF QUESTION PRESENTED.

Respondent, an American citizen, owned shares of stock in certain British corporations. Dividends in the gross amount of $31,010.83, were declared on his shares during 1931. Of this amount $23,993.72 was physically or manually paid in cash to respondent during 1931, the remaining $7,017.11 having been deducted and withheld by the corporations as United Kingdom income tax appropriate to the dividends pursuant to the United Kingdom Income Tax Act of 1918, as amended. Under the British Law respondent was required to submit to this deduction of income tax from his dividends, and the corporations were required to and did certify to respondent the gross amount of each dividend, the income tax appropriate thereto, and the net amount payable in cash after deduction of income tax.

The sole question presented is whether, under Section 131 of the Revenue Act of 1928, all or any por-

tion of the $7,017.11 United Kingdom income taxes so paid by deduction from respondent's British dividend income should be allowed as a credit against his Federal income tax, and the balance thereof, if any, not available as a credit, allowed as a deduction from gross income under Section 23(c) of said Act.

STATUTES INVOLVED.

Respondent claimed as a credit against income taxes due the United States that portion of his United Kingdom income tax available as a credit, pursuant to the provisions of Section 131 of the Revenue Act of 1928, c. 852, 45 Stat. 791, which follow:

> "Sec. 131. Taxes of Foreign Countries and Possessions of United States.
>
> (a) Allowance of Credit—The tax imposed by this title shall be credited with:
>
> (1) Citizen and Domestic Corporation.—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and
>
> * * * * * * *
>
> (b) Limit on Credit.—In no case shall the amount of credit taken under this section exceed the same proportion of the tax (computed on the basis of the taxpayer's net income without the deduction of any income, war-profits, or excess-profits tax any part of which may be

allowed to him as a credit by this section), against which such credit is taken, which the taxpayer's net income (computed without the deduction of any such income, war-profits, or excess-profits tax) from sources without the United States bears to his entire net income (computed without such deduction) for the same taxable year."

Respondent claimed as a deduction the balance of his United Kingdom income taxes not available as a credit, under Section 23(c) (2) of the Revenue Act of 1928, which follows:

"SEC. 23. Deductions from Gross Income.

In computing net income there shall be allowed as deductions:

* * * * * * *

(c) Taxes Generally—Taxes paid or accrued within the taxable year, except—

* * * * * * *

(2) so much of the income, war-profits, and excess-profits taxes imposed by the authority of any foreign country or possession of the United States as is allowed as a credit against the tax under Section 131; and * * *."

COUNTER-STATEMENT.

The respondent is a citizen of and resides in the United States. Throughout the calendar year 1931 respondent owned shares of stock in corporations organized and existing under the laws of Great Britain, as follows:

10,617 Ordinary shares of stock, par value one pound each, of the British-American Tobacco Company, Limited;
1,327 Ordinary shares of stock, par value one pound each, of Tobacco Securities Trust Company, Limited;
1,327 Shares of Deferred stock, par value five shillings each, of Tobacco Securities Trust Company, Limited; and
9,500 Ordinary shares of stock, par value one pound each, of The Imperial Tobacco Company (of Great Britain and Ireland), Limited (R. p. 16).

During the year involved the corporations declared and paid dividends to respondent on these shares, deducting from each of such dividends United Kingdome income tax at the "standard rate" (fixed rate analogous to Federal "normal" tax) appropriate to each dividend and paying to respondent the net amount remaining* pursuant to the provisions of Rule 20 of General Rules of the United Kingdom Income Tax Act of 1918 (R. pp. 17-21; Appendix "A," p. 199 of Petitioner's Exhibit No. 1), as amended by Section

*The aggregate amounts involved are as follows:

	Gross Amount of Dividend	Amount deducted as British Income Tax by corporations	Net amount received in cash
British - American Tobacco Company, Limited	$16,082.23	$3,743.98	$12,338.25
Tobacco Securities Trust Company, Limited	1,018.30	201.27	817.03
The Imperial Tobacco Company, Limited	13,910.30	3,071.86	10,838.44
	$31,010.83	$7,017.11	$23,993.72

39 (1) of the Finance Act of 1927 (R. Appendix "A," p. 29 of Petitioner's Exhibit No. 10).

Each dividend warrant transmitted by the respective corporations to respondent was required by law to be, and was, accompanied by a statement showing:

> "(*a*) the gross amount which, after deduction of the income tax appropriate thereto, corresponds to the net amount actually paid; and
> (*b*) the rate and the amount of income tax appropriate to such gross amount; and
> (*c*) the net amount actually paid,"

pursuant to Section 33 (1) of the Finance Act of 1924 (R. pp. 25-67, 114-116, 131-132; Appendix "A," p. 19 of Petitioner's Exhibit No. 7).* This statement is a receipt for or proof of payment of income tax by deduction. In the marginal note to Section 33 (1) of the King's Printer's Copy of the Finance Act of 1924 the statement is called an "Explanation of income tax deduction to be annexed to dividend warrants" by Parliament (R. Appendix "A," p. 19 of Petitioner's Exhibit No. 7). These statements bear the following legend on their face (R. pp. 25, 29, 33, 37, 41, 45):

> "Shareholders claiming relief from British Income Tax are informed that the Inland Revenue authorities will accept this statement as proof of payment of British Income Tax and it should, therefore, be preserved."

* Petitioner sets forth the actual requirements of the British law at page 18 of his brief, although they are misstated elsewhere therein (pp. 2 and 9).

The Tobacco Securities Trust Company, Limited, declared its dividends in a gross amount without specifically referring to British or United Kingdom income taxes. In transmitting dividend warrants to its shareholders it deducted the British or United Kingdom income tax appropriate thereto, and sent its check for the net amount remaining (R. pp. 18-19, 41, 45). British-American Tobacco Company, Limited, and Imperial Tobacco Company (of Great Britain and Ireland), Limited, declared their dividends "free of British Income Tax" (R. pp. 17, 19, 25, 29, 33, 37, 53, 61) ["Free of tax" when used in relation to a dividend declared by a British company was held by the House of Lords in *Ashton Gas Company* v. *The Attorney General,* [1906] Appeal Cases 10, to mean a dividend of such a sum as after the deduction of income tax at the appropriate rate amounts to the net sum actually paid to the shareholder (R. p. 128), and the Board of Tax Appeals so found (R. p. 90). It does not mean that the dividend has not been subjected to or charged with income tax (R. p. 125).] It is a well-settled principle in the United Kingdom that for all the purposes of the income tax acts there is no difference between a "free of tax" dividend and a "gross, less tax" dividend of the same "net" amount. These two forms of declaration of dividends are precisely the same in effect, and the same "Explanation of income tax deduction" is required to be furnished to the shareholder by the corporation (R. p. 126).

In addition to paying United Kingdom income taxes at the "standard rate" by deduction, since the gross amount of respondent's British dividend income was in excess of £2,000, he was required to file a British tax return for Sur-tax due to the United Kingdom in which he was required to and did report the gross amount of his British dividends without any reduction for United Kingdom income taxes deducted at the "standard rate." Thereafter, the Special Commissioners of Inland Revenue of Great Britain made an assessment of Sur-tax and served notice thereof on respondent (R. p. 73) and respondent paid Sur-tax in the amount of $2,189.91, in accordance therewith (R. pp. 21, 22, 75).

In respondent's Federal income tax return for the year involved he reported as "Dividends from Foreign Corporations" the gross foreign dividends; *i. e.,* the amounts actually received in cash from the dividend paying corporations plus the amounts deducted by those corporations as United Kingdom income taxes appropriate to such dividends (R. pp. 22, 77). Respondent computed the portion of the United Kingdom income tax on his dividends available as a credit against his Federal income tax pursuant to Section 131 of the Revenue Act of 1928, and claimed the balance of said amount, not available as a credit, as a deduction from gross income pursuant to Section 23(c) of said act. The claim for credit under Section 131 amounted to $5,044.99, and the deduction under Section 23(c) for the balance not allowable

as a credit amounted to $4,162.03. Respondent claimed the credit, determined as above set forth, on Form 1116 (R. p. 83), filing therewith and in support thereof certain documents (R. pp. 25-67), the form of which had always been regarded by petitioner as satisfactory evidence for the allowance of the credit claimed. The petitioner disallowed the entire amount of $5,044.99 as a credit on account of foreign income taxes and excluded it from gross income (R. p. 23). In making this adjustment petitioner disallowed respondent's claim for credit on account of United Kingdom income tax at the "standard rate," and also disallowed respondent's claim for credit on account of additional United Kingdom income tax or Sur-tax. However, at the hearing before the Board of Tax Appeals petitioner conceded that respondent had paid income tax to a foreign country in respect of the additional United Kingdom income tax or Sur-tax, and was entitled to a credit for $2,189.91 (R. p. 89).

The question presented to the Board involved the facts of the history, interpretation and construction of the various income tax laws of the United Kingdom, the decisions of the British Courts, and the administrative practice of the Department of Inland Revenue of Great Britain. Therefore respondent, in addition to offering documentary evidence of the British law, introduced Frank Heyworth Talbot, Barrister at Law of London, as an authority on these matters (R. p. 90). Talbot is engaged in active practice dealing almost exclusively with revenue

matters. His experience in income tax law has covered more than twenty years, including many years as one of the chief executive officers of the Department of Inland Revenue charged with the administration of income taxes. His broad experience and outstanding qualifications were not questioned, and are set forth in the Record at pages 110 and 111. No evidence, expert or otherwise, was adduced to contradict his positive and unambiguous testimony in any respect.

The evidence before the Board of Tax Appeals showed that under English law respondent paid by deduction United Kingdom income tax at the "standard rate" upon the gross amount of his British dividend income. The Board of Tax Appeals recognized Mr. Talbot as an "authority on British income tax law" (R. p. 90), adopted his testimony with reference to British law and practice (R. pp. 91-94), and made the following statement in its opinion (R. pp. 93-94):

> "The stockholder receiving the dividend is regarded by the English income tax acts as having paid 'by deduction or otherwise' the tax 'appropriate' to the dividend. The stockholder is not required to pay any income tax at the standard rate upon the amount of cash distributed to him by the corporation. He may, however, be subject to a surtax, and in making his surtax return the stockholder is required to include in his gross income not only the amount of the distribution received from the corporation but

that amount plus the tax 'appropriate' thereto. On the other hand, the stockholder receiving the dividend may not, by reason of exemptions and relief provisions of the income tax acts, be required to pay the full amount of the tax represented by the tax 'appropriate' to the dividend. In such case the stockholder is entitled to file a claim for refund with the English authorities and upon the proof of claim is entitled to recover a part or all of the tax 'appropriate' to the dividend.

"The British income tax acts in force in the taxable years further provide that the corporation in paying the dividend may deduct from the dividend the tax 'appropriate' thereto. Thus, where the earnings of a corporation in a given year amount to £1,000 and the standard rate of income tax is 25 percent, the corporation pays to the Crown a tax of £250 and has left £750 to distribute to its stockholders. It may declare a dividend in the gross amount of £1000 'less income tax,' in which event the stockholders receive £750. On the other hand, it may declare a dividend 'free of income tax,' in which event the dividend is declared in the amount of £750 and the stockholders receive £750. In either case the stockholders are regarded as having paid an aggregate income tax of £250 in respect of the dividends received by them. * * *"

Notwithstanding, it approved the petitioner's action in disallowing the credit claimed by respondent.

The Circuit Court of Appeals for the Third Circuit accepted the expert's conclusion, called attention to certain principles of English law "which taken

together show the shareholder is the taxpayer," and reversed the decision of the Board of Tax Appeals, holding that the question whether respondent had paid United Kingdom income tax on his dividend income was "governed by the laws of England" (R. pp. 388-391).

Prior to the decision of the court below in the present case the Circuit Court of Appeals for the Second Circuit, having expressly accepted the expert's conclusion, refused to follow the English law and affirmed the Board in the case of *Mary Duke Biddle* v. *Commissioner,* 86 F. (2d) 718, which case was consolidated with the present one for hearing before the Board of Tax Appeals.

Certiorari has been granted in this case and the *Biddle* case, which is No. 55, present Term, to resolve the conflict.*

SUMMARY OF ARGUMENT.

The question presented, did the respondent pay United Kingdom income tax by deduction from his British dividend income, is necessarily governed by the laws of England. The entire Record, including the agreed statement of facts, the uncontradicted testimony of the expert, the documentary evidence of British law, the review of British law and practice in the opinion of the Board of Tax Appeals, and the observations of the court below, demonstrates beyond all doubt that respondent *paid* United King-

* The Circuit Court of Appeals for the First Circuit expressly disapproved of and refused to follow the *Biddle* case in *United Shoe Machinery Corp.* v. *White,* 89 F. (2d) 363, reversing 13 F. Supp. 97, petition for certiorari pending.

dom income tax at the "standard rate" on his British dividends by deduction.

Under the United Kingdom Income Tax Act and the Finance Acts respondent was required to submit to a deduction of income tax in the amount of $7,017.11 from his British dividend income. This tax is levied as an income tax under the British statutes; it is measured by the gross amount of each dividend; it is imposed at the "standard rate" of income tax applicable to all income, and is the exact amount which the shareholder would be required to pay if he had actually received the entire gross amount of the dividend and were subject to a direct assessment; and under proper circumstances all or a part of it may be recovered by the shareholder from the Crown as an over-payment of income tax under the refunding provisions in Part III of the Income Tax Act of 1918, which apply to all income tax, however collected or paid.

It being clear that the tax in question is an income tax withheld from respondent's dividend income pursuant to the laws of England, it necessarily follows that respondent has paid income tax to a foreign country and is, therefore, entitled to credit against his Federal income tax pursuant to the provisions of Section 131 of the Revenue Act of 1928.

The decision of the court below sustains and approves the petitioner's published rulings and settled and uniform practice of over fifteen years' standing. These have received Congressional approval through successive reenactments of the credit provisions with-

out substantial change since 1918. Nevertheless petitioner, without revoking his rulings, now attempts to repudiate them and reverse his practice.

ARGUMENT.

I.

THE COURT BELOW CORRECTLY HELD THAT THE QUESTION HERE PRESENTED IS GOVERNED BY THE LAWS OF ENGLAND.

(*a*) General Statement.

Whether respondent is entitled to the foreign tax credit claimed against his Federal income tax liability for 1931 depends entirely upon the answer to the question: Did respondent pay United Kingdom income tax with respect to his British dividend income during 1931? The court below properly held that "The answer is governed by the laws of England" (R. p. 38).

It is mainly upon this ground that the Circuit Court of Appeals for the Second Circuit in the *Biddle* case and the court below divide. In the Second Circuit the court expressly accepted the expert's conclusion based on the English law and administrative practice, but held that the question whether United Kingdom income tax had been paid was not controlled by English law. All authorities hold to the contrary, namely, that the English law and what is done thereunder in England conclusively determines whether an English income tax had been paid.

In refusing to accept the English law as controlling, the Circuit Court of Appeals for the Second Circuit, in the *Biddle* case, not only failed to follow its own case of *United Dyewood Corp.* v. *Bowers,* 56 F. (2d) 603, but acted contrary to every decided case we have been able to find on the question. The rule adopted and followed by the court below in this case has been followed by the Circuit Court of Appeals for the First Circuit, in the case of *United Shoe Machinery Corp.* v. *White,* 89 F. (2d) 363, which involved the same question.

In *Columbian Carbon Co.* v. *Commissioner,* 25 B. T. A. 456, 465, another case involving a claim for credit against Federal income tax for income taxes paid to Great Britain, the Board of Tax Appeals held that:

> "The question here presented is governed by the laws of England * * *".

To the same effect are *Burns* v. *Commissioner,* 12 B. T. A. 1209, 1225; *Keene* v. *Commissioner,* 15 B. T. A. 1243, 1246; *Eitingon-Schild Co.* v. *Commissioner,* 21 B. T. A. 1163; *Mallouk* v. *Commissioner,* 34 B. T. A. 269, 273; *Commissioner* v. *Briskey Co.,* 78 F. (2d) 816 (C. C. A. 3rd).

It is, therefore, clear that the court below correctly held that it was bound by the English law, and that the refusal of the Circuit Court of Appeals for the Second Circuit to accept the English law as controlling the present question constitutes reversible error.

Before concluding this section of our argument we desire to call attention to the fact that the court

in the *Biddle* case fell into this error (*a*) by failing to distinguish between income taxes collected by direct assessment and those collected by deduction at the source, and (*b*) because of an entirely mistaken belief that the so-called "ultimate burden" theory controls the determination of this issue. Contrary to well-accepted principles, that court states that "our system of credits and deductions is built around a concept of direct liability for taxation and direct payment" (p. 720); that is, a physical or manual payment by the shareholder under a direct assessment must be shown. No authority is or can be cited for such a conclusion. It completely disregards and excludes payment by deduction at the source, which is contemplated in the very terms of Section 131(b) of the Revenue Act of 1928. In pointing out the error in this view the court below stated (R. p. 391):

> "We respectfully differ with the learned Judge's conclusions. In the first place, the Government, as noted (4) *supra,* has conceded that direct payment is not essential. Indeed, the doctrine of constructive receipt and payment is recognized in our system. *Old Colony Trust Co.* v. *Commissioner,* 279 U. S. 716, 49 S. Ct. 499. And in the second place, the Revenue Act expressly allows a credit for payment of foreign income tax."

The reasoning in the *Biddle* case was rejected by the First Circuit in the *United Shoe Machinery Co.* case, *supra,* in these words (p. 366):

> "But in the Biddle case it was held * * * that although it was a tax on the shareholders, it was not 'paid by' them within the meaning of our law. We are unable to agree."

The court in the *Biddle* case also states that a shareholder in a British corporation is not a taxpayer, but merely bears the "ultimate burden" of the corporation's tax, citing its own case of *Shearer* v. *Commissioner,* 48 F. (2d) 552. The *Shearer* case did not deal with a statutory deduction of tax at the source, but involved an excise tax imposed directly on the dealer, and it was only a matter of private contract between the dealer and the purchaser, which shifted the ultimate burden of the former's tax to the latter. The United Kingdom income tax here and the "statutory incidence" thereof was imposed directly upon the respondent and other shareholders when that tax was deducted from their dividends pursuant to statutory authority in the United Kingdom Income Tax Act of 1918. Under that Act requiring shareholders to submit to the deduction of income tax from the gross amount of their dividends upon pain of penalty, it cannot seriously be contended that the shareholder is not "the party which the taxing authority has made directly responsible" (*Biddle* v. *Commissioner, supra,* at p. 721). That the shareholder in a British corporation is an income taxpayer and does more than bear the final incidence of the tax is further demonstrated by the considerations set forth in the opinion of the court below in this case (R. pp. 389-391). The Circuit Court of Appeals for the Second Circuit has passed

over these important matters, apparently without appreciating their significance. The question involved is manifestly not one of mere "ultimate burden," but, on the contrary, is one of "ultimate statutory liability."*

Returning to the principal ground upon which the Circuit Court of Appeals for the Second Circuit, and the court below in this case divide, it is interesting to note that in petitioner's brief he attempts to show that the law of England is not in accord with the expert's conclusion, and the discussion in the opinions of the Board of Tax Appeals and the court below in this case. We submit that such a tacit admission that the court below was correct in holding that the English law was conclusive and that the Second Circuit was in error in refusing to so hold, is ground for affirmance of the decision of the court below in this case and reversal of the decision of the Second Circuit in the *Biddle* case.

(*b*). British Law and Practice.

Petitioner has devoted a considerable portion of his brief to his understanding of the English law appearing in the Record in this case and in reported British decisions by wresting certain testimony of the

* At page 30 of his brief petitioner wrests a few words from the opinion of the court below in an attempt to make it appear that the court misconceived the issue. Petitioner states:

> "The court below conceives the question to be whether the amount certified as income tax 'appropriate to' the dividends was tax 'directly borne by the petitioner, or was it a tax imposed upon and borne by the British companies'? (R. 388). Whether the taxpayer bore the ultimate burden of an income tax imposed by Great Britain is not the question."

Reference to page 388 of the Record will show that Judge Buffington was not referring to the "ultimate burden" theory, but clearly understood that the question was whether respondent paid income tax under the provisions of the English law.

expert from its context and isolated judicial observations in British cases from their context. It is submitted that an examination of the entire Record, particularly pages 114, 116, 119-123, 124-126, 135, 141, 156, 173, 184, makes it abundantly clear that the statutory deduction of United Kingdom income tax at the standard rate from the gross amount of respondent's dividend income constitute a payment of income tax by respondent.

Petitioner's argument concerns itself with an attempt to show that in England the income tax deducted at the source from dividends is not a "tax" and is not "paid." Throughout petitioner fails to distinguish between income taxes collected under direct assessment and income taxes collected by deduction at the source, although he concedes that 70% of income in England—which figure incidentally includes dividend income—is taxed by deduction at the source.*

There is no separate British "corporation income tax" such as we have (R. pp. 126, 177). From 1920 through 1924 there was such a separate tax in England, but it was repealed. It is, therefore, futile to attempt to draw any supposed analogy between Federal corporate income tax paid by our corporations and United Kingdom income tax imposed at the "standard rate." The analogy drawn by petitioner at page 31 of his brief fits the corporation tax in effect in England prior to 1924, but simply

* The 70 per cent of income taxed by deduction at the source includes income from dividends (R. pp. 123-124). Petitioner thus must be taken to have admitted that income tax on respondent's dividends was paid by deduction at page 15 of his brief, or to have failed to appreciate the significance of this statement.

does not exist with reference to taxes imposed under the United Kingdom Income Tax Act of 1918.

A British corporation pays income tax by direct assessment on its profits from trade. A shareholder pays income tax by deduction from the gross amount of his dividend income (R. pp. 127-128, 135, 141, 163-165, 173, 177).

The expert went to great lengths to explain the English system which is relatively simple and certainly very effective in operation, but petitioner has failed to understand it and would have this Court believe that it is based on fancy. There is nothing theoretical or fanciful about the deduction of income tax from dividend income—it is *real* and the shareholder is out of pocket by reason thereof. The shareholder's is the ultimate statutory liability for his own tax and not the ultimate burden of the tax on the company's profits.

Thus petitioner's argument narrows down to a criticism of and disagreement with the manner in which the English system is administered in practice, and is clearly not a showing that the shareholder has not paid income tax by deduction from his dividend income. Surely we, who are still in the trial and error stage of income tax administration, have no monopoly on the subject, and precise administrative similarity to our system is not essential for the allowance of credit. The English system has been in successful operation for over a century with very little change, and is generally

conceded to be the finest in the world from an administrative standpoint.

Petitioner seizes upon minor variations in income tax rates in England, and points out that the shareholder's tax may be deducted from his dividend at a different rate from that at which the company paid tax on its profits then being distributed, because the profits may have been earned in an earlier year when the tax rate was higher or lower. This again is merely criticism of administrative details, and not evidence that the shareholder has not paid income tax on his dividends. As a practical matter these variations have little or no effect on the Revenue, and Parliament has never seen fit to change the method (R. p. 174-175). As stated by the expert witness (R. p. 159):

> "* * * Our law is so curiously framed that to the mind of the lawyer not accustomed to the operation of the principle of deduction of tax at the source, it must all seem very strange. Regarding the position, taking one year with another, and looking over a series of years, long series of years, and income tax has been in operation in our country for a very long period of time, as you know, taking the whole period of years, the result is that the Crown gets the right amount in the aggregate. Indeed, the Crown gets in one year or another, in the long run, all the 'tax appropriate' that has been deducted from dividends paid by the company."

If these relatively simple principles of the English system are borne in mind, it is manifest that the decision of the court below was correct. That the

administration of the English income tax laws does not square with petitioner's views does not make it artificial or unreal.

So clear is the shareholder's position that the expert testified (R. p. 141):

> "In my experience in income tax administration, extending over twenty years, the point at issue in this case * * * has never arisen and I doubt that it could arise. It has never been questioned in England that when tax is deducted the deduction constitutes a payment of tax."

At the risk of burdening this brief with quotation from the Record, we submit the following statement from the opinion of the court below as an admirable summary of the English law (R. pp. 389-391):

> "Any hesitancy in accepting the expert's opinion of the British law is dispelled when we consider these principles, which taken together show the shareholder is the taxpayer:
>
> "(1) In general the English income tax acts are based upon the principle of collection of tax at the source. Lord Halsbury, in "Laws of England", Volume XVII, p. 12, says:
>
> 'So far as possible, income tax is collected at the source, and persons paying rent, annual interest or annual payments deduct tax on making the payment'."

See also Hamilton *v.* Commissioners of Inland Revenue, [1931] 2 K. B. 495. E. M. Konstam, K. C. in his work on The Law of Income Tax (6th Ed.) p. 4, states:

> 'The person who is ultimately liable for the tax either pays it under a direct assessment, or

submits to a deduction of tax at the hands of some other person from whom he is entitled to receive money; and so important is the latter method of collection that at the present day at least 70 per cent of the yield of the tax is collected by it.'

"Konstam's conclusions and opinion are that the shareholders' income tax upon their dividends is deducted 'at the source'. See 6th Edition, pp. 269, 270.

"(2) An English company is bound under penalties to show in its dividend warrants, not only the net amount actually paid, but the gross amount corresponding to that, and the rate and amount of income tax appropriate to that gross amount. Section 33, Finance Act of 1924. This, of course, is also information that the taxpayer needs, so that the gross amount may be considered in the computation of the super-tax, and is used as a basis for the application of relief by way of repayment for taxpayers in the lower brackets. The form of the return, although not conclusive in itself, at least is persuasive, that the payment is made by the company on behalf of the shareholder.

"(3) The English method in calculating the sur-tax also supports the opinion of the expert. Under Section 4 of the United Kingdom Income Tax Act of 1918, a super-tax is defined as an 'additional duty of income tax'. This tax was replaced in Section 38 of the Finance Act of 1927, and called a surtax. In determining the amount of the surtax, the gross amount of a dividend declared, before deduction of income tax, is used. It is not likely Parliament would use as

a base for determining 'additional income tax' a tax paid by the company directly. Specifically, the Board has allowed petitioner a deduction for the payment of his surtax of $2,189.91. That figure is arrived at by computing his total gross income, including tax paid at source. This figure being accepted as correct, it is but a recognition of the fact that the deduction at the source was income tax 'appropriate to' the dividend petitioner received.

"(4) The deductions made from dividends paid on shares bearing a fixed rate indicate that the shareholder is paying the tax and not the company. See *Ashton Gas Co.* v. *The Attorney General,* [1906] A. C. 10, where the shares bore a preference dividend limited to 10 per cent., and it was held the company could not pay a 10 per cent. 'free of tax' dividend. Notwithstanding the contractual obligation to pay a certain fixed dividend, the company deducts what the shareholder is required to pay and pays it at the source to the Crown.

"(5) The language of the taxing statutes would indicate that it is the shareholder who pays the tax through this process of withholding or deduction. The wording is always if a person 'has paid any tax, by deduction or otherwise,' or 'has been charged with tax by deduction or otherwise.' See Income Tax 1918, Part III, Section 29 (1), Part IV, Section 55 (1), Part X, Section 211 (1). See General Rules Income Tax, 1918, Sections 20, 23. See Finance Act, 1920, Section 27 (1).

"(6) If the payment is not made on behalf of the shareholder, why does the English law permit

relief and rebate of the payment to taxpayers in the lower brackets? Income Tax Act, 1918, 8 and 9 George V, Chapter 40, Part III. The simple effect of this provision is to return to the taxpayer tax withheld from income which was not subject to a tax, but which the company was in the first instance required under the law to pay to the Crown.[5]

"We refrain from discussing the English authorities cited by both sides as giving comfort to the opposing contentions. We do so because of the admission of the expert on English income tax law that the point here at issue has never risen in any case.[6] We accept the English law, as stated by the expert, that the tax is paid by the shareholder by deduction, especially when this is buttressed by the principles above stated."

Perhaps the most important proof from a practical standpoint is the situation in the case of fixed

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[5] "Mr. Talbot, the British expert, testified (p. 124):

'* * * provision is made for the relief of such persons from taxation and an individual whose total income from all sources does not exceed 100 pounds per annum is entitled to exemption from income tax altogether. By reason of the operation of the principle of deduction of income tax at the source, many hundreds of thousands of people in England, although their particular incomes are exempted from income tax by law, receive their income in the form of dividends from which income tax has been or purports to have been deducted by the dividend-paying companies. At the end of the income tax year, these people present to the Inland Revenue Department at the office of the district inspector for their locality, claims for repayment of taxes deducted from their dividends. * * * In the course of my service as a district inspector, I must have paid out of the National Exchequer many millions of pounds sterling, which could have been paid out properly only if tax deducted from the dividends of the dividend-paying companies was tax paid by the recipients of those dividends'."

[6] "Mr. Talbot testified (p. 141):

'In my experience in income tax administration, extending over twenty years, the point at issue in this case, namely, whether or not the tax in question was paid by the company or paid by the shareholder, has never arisen and I doubt that it could arise. It has never been questioned in England that when tax is deducted the deduction constitutes a payment of tax'."

dividend shares or preferred shares limited as to the amount of dividend, referred to in paragraph (4) of the above quotation, and utterly ignored by petitioner throughout his brief. In such cases, the gross dividend, before the deduction of income tax, must remain constant; and it is therefore impossible for the company to declare a dividend in the full amount "free of tax." This situation is illustrated by *Ashton Gas Company* v. *The Attorney-General,* [1906] A. C. 10 (R. p. 128). That case involved a public utility authorized to pay preference dividends limited to 10%. The Company in prior years had declared a gross dividend of 10% and specifically deducted income tax therefrom before distribution to its shareholders. In the year giving rise to the litigation, it declared a "free of tax" dividend of 10%. It was held by the House of Lords that the declaration of a "free of tax" dividend of 10% was *ultra vires* because, in effect, the Company gave its shareholders a dividend in excess of the 10% limitation—that is, when income tax was added back to the 10% net to ascertain the gross dividend, a dividend in excess of 10% resulted. This case formed the basis of the court's opinion in the recent case of *Commissioners of Inland Revenue* v. *Pearson,* [1936] 2 K. B. 533. The practical effect of this is to make the amount of the shareholder's dividend received by him in cash vary according to the tax rate in effect for the particular year. For example, if the tax rate in the particular year is 5 shillings in the pound (or 25%) the shareholder entitled to a fixed rate dividend of 10% would actually receive three-fourths of 10% in

cash; if the rate in the particular year was 4 shillings in the pound (or 20 %), such shareholder would actually receive four-fifths of 10% in cash. When the shareholder's return on his investment is thus made to vary directly with the standard rate of income tax in effect for the particular year, it is fallacious to say that he does not pay income tax when it is deducted from his dividend at the source, or that the tax is a "theoretical amount" which does not square with the facts. It is the fact.

At page 17 of petitioner's brief Rule 20 of General Rules is set forth in its original form prior to its amendment by Section 39(1) of the Finance Act of 1927 entitled "Provisions with respect to income tax chargeable by way of deduction" (R. Appendix "A," p. 29 of Petitioner's Exhibit No. 10). By this amendment the "appropriate" tax is at the rate in effect when the dividend is paid. The word "appropriate" merely means that tax is to be deducted in exactly the same amount as though the shareholder had actually received the gross amount of the dividend and were required to pay income tax thereon under a direct assessment.* This being the shareholder's tax on his dividend income, it is clear that it need have no relationship to the company's tax on its profits.

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*Throughout petitioner's brief "appropriate to" has been set off in quotation marks as though it had some special significance, which is nowhere explained.

Lord Justice Romer gives the following definition in *Hamilton* v. *Commissioners of Inland Revenue*, 16 British Tax Cases 213, 236 (R. p. 288):

> "* * * it is quite obvious that the appropriate tax to be deducted from the dividend is a tax which the taxpayer himself would have to pay if he were assessed directly in respect of that dividend."

There can be no question that the amount so deducted is income tax on the shareholder imposed under the Acts of Parliament. Under Rule 23 of General Rules of the United Kingdom Income Tax Act of 1918 (R. Appendix "A," p. 200 of Petitioner's Exhibit No. 1) a shareholder is required to submit to this deduction of income tax under pain of penalty. In addition to this, where a dividend is paid under certain circumstances without deduction of income tax Section 211 of the United Kingdom Income Tax Act of 1918 (R. Appendix "A," p. 133 of Petitioner's Exhibit No. 1) provides a means for *direct assessment against the shareholder*. Neither the Board of Tax Appeals, the Circuit Court of Appeals for the Second Circuit, nor the petitioner has anywhere referred to this section of the law. Its significance, however, was recognized by the court below (R. p. 390).

Petitioner on page 19 of his brief states that "Dividends upon stock in British corporations are not subject to tax when received by the shareholder." We concede the literal accuracy of this statement, but deny the implication that dividends are never subject to income tax. The important words are "when received by the shareholder." They are not subject to tax "when received," because *income tax at the standard rate has already been paid on them by deduction at the source before distribution* (R. pp. 135, 137-138, 140, 146, 150, 151, 153). Petitioner's statement is repeated in a slightly different form on page 32, and again at page 35 of his brief in the quotation of an

isolated paragraph from Lord Tomlin's opinion in *Neumann* v. *Commissioners of Inland Revenue,* 18 British Tax Cases 332 (R. p. 297), to the effect that dividends are not taxable under Schedule D of the United Kingdom Income Tax Act. An examination of the Act shows that Schedule D deals only with *direct assessments* on income in the hands of the taxpayer (R. Appendix "A," p. 173 of Petitioner's Exhibit No. 1). Consequently Lord Tomlin's remarks mean nothing more than what they say, *viz.,* that dividends are not subject to tax by direct assessment (under Schedule D) in the hands of the shareholder. With this we agree. As stated by the expert witness, Mr. Talbot (R. p. 150):

> "* * * dividends are not taxable at the standard rate under Schedule D for the reason that they have already been taxed by deduction at the source."

To the same effect is the observation of the Lord Chancellor in *Bradbury* v. *English Sewing Cotton Co.,* [1923] A. C. 744, where an attempt was made to make a direct assessment of tax against dividend income from which income tax had already been deducted at the source before distribution. At page 752 His Lordship stated that the dividends "have already paid tax by deduction, and could not now be taxed again." The foregoing discussion, of course, is subject to the qualification that where income tax has not been deducted before distribution in the situation described in Section 211 of the United Kingdom

Income Tax of 1918 (R. Appendix "A," p. 133 of Petitioner's Exhibit No. 1), the dividends are subject to direct assessment in the hands of the shareholder.

Petitioner at page 20 refers to the income tax deducted from respondent's British dividend income as a "theoretical amount" which is not a part of respondent's total taxable income, and again at page 27 he states that it serves the purpose of enabling the Crown to increase its revenue by requiring a taxpayer to pay Sur-tax on income never received. In the first place, payment by deduction is a well established principle of taxation, and as stated by the court below "the doctrine of constructive receipt and payment is recognized in our system" (R. p. 391). In the second place, Section 131(b) of the Revenue Act of 1928—the very section now before this Court—requires the foreign income tax to be included as a part of taxable income. In the third place, petitioner in this case conceded that the tax deducted was a part of respondent's foreign income when he confessed error and allowed credit for United Kingdom Sur-tax (additional income taxes) based thereon before the Board of Tax Appeals (R. p. 89). Finally the statement that a tax imposed on dividend income and measured at the standard rate applicable to all other income is a "theoretical amount" which serves to increase Sur-tax revenue is illogical. Parliament can hardly be taken to have set up an elaborate procedure for deduction of tax at the source and allowed it to remain in effect for over a century, if the end

to be served was merely one which could have been attained by increasing the Sur-tax rate.

As noted by the court below the Sur-tax provisions of the English law afford an excellent practical illustration of the fact that income tax at the "standard rate" is paid by the shareholder by the process of deduction. In reporting total taxable income for Sur-tax purposes the English law requires the taxpayer to include the gross amount of his dividend. When a taxpayer's taxable income is thus made to include not only the net amount actually received in cash but, in addition, the amount of income tax deducted from his dividend, unquestionably the amount deducted constitutes a payment of tax by him from his dividend income. Ample support for this statement is found in the case of *Marion Brooke* v. *The Commissioners of Inland Revenue,* 7 British Tax Cases 261 (R. p. 195). In that case the taxpayer contended that she was not liable to pay Sur-tax (the technical name of the tax at that time was "Super-tax," but the tax involved was in all respects the same as the present day Sur-tax in England), because she had not paid an income tax. Her entire income came to her from dividends from which income tax at the standard rate had been deducted by the payors before distribution. The court recognized her contention that Sur-tax was an additional income tax and that a person must first be liable to pay income tax at the standard rate before liability for Sur-tax could arise. However, it held that she

was liable to and had paid income tax at the standard rate when the tax was deducted from her dividends at the source and, therefore, that she was liable to pay Sur-tax on her dividend income. As Super-tax was an "additional duty of income tax" [Section 4 of the United Kingdom Income Tax Act of 1918 (p. 2 Petitioner's Exhibit No. 1, Appendix "A")]; and as Sur-tax, which superseded and replaced Super-tax, is merely a part of the same (R. pp. 132-133) income tax charged at a rate in excess of the standard rate [Section 38 of the Finance Act of 1927 (p. 28 of Petitioner's Exhibit No. 10, Appendix "A")], it necessarily follows that for all purposes of the Income Tax Acts a deduction of tax from a dividend at the source is a payment of tax by the shareholder out of his own income.

The petitioner here, while conceding that respondent is entitled to credit for the additional part of his British income tax, *viz.*, Sur-tax, has adopted the anomalous and untenable position that credit is not allowable for respondent's British income tax at the standard rate on *the identical dividend income.* In allowing respondent full credit for United Kingdom Sur-tax paid upon the gross amount of his British dividends (the net amount received in cash plus income tax withheld at the "standard rate") petitioner must be taken to concede that that portion of the gross amount of the dividend representing tax withheld at the "standard rate" is *income constructively received by respondent.* If that portion of the gross amount of the dividend representing tax withheld at

the "standard rate" were merely a "theoretical amount" which respondent never received as now contended by petitioner, Sur-tax imposed with respect thereto would scarcely be an income tax.

On pages 20 through 22 petitioner sets forth the relief or refund provisions of the United Kingdom Income Tax Act of 1918 and the Finance Act of 1920, which demonstrate conclusively that income tax deducted from dividends is income tax paid by the shareholder—and paid by him to the Crown. He attempts to minimize their importance by referring to them as applying only to "earners of small income." A reading of these sections shows that this statement is incorrect. They apply to all persons who have overpaid tax, irrespective of the size of their incomes, and are especially important where all or a large part of the taxpayer's income has been subjected to tax by deduction at the source, without giving effect to losses, expenses of management, or other allowable deductions. They also apply to insurance companies, savings banks and investment companies, the bulk of whose income is derived from stocks and investments and is, therefore, subjected to tax before receipt: Section 33(1) of the United Kingdom Income Tax Act of 1918 (Petitioner's brief, p. 21; R. Appendix "A" p. 19 of Petitioner's Exhibit No. 1). Without such provisions these taxpayers would be subjected to income tax on practically all their income before receipt, with no allowance whatever for losses, expenses, etc. If further proof

were needed to show that income tax deducted from dividends is income tax paid by the shareholder to the Crown, it is to be found in the language used in these sections and the practice of the Department of Inland Revenue of Great Britain thereunder. Section 29 provides for a refund where any person "has paid any tax, by deduction or otherwise" and sub-section 2 refers to the "different sources of income in respect to which tax has been paid," which "sources" include income from dividends. Section 32 refers to any person who "has paid or has been charged with tax by deduction or otherwise." This also includes shareholders who have paid tax by deduction from their dividend income. Section 34(2), which is not printed in petitioner's brief but which appears in the Record (Appendix "A," p. 21 of Petitioner's Exhibit No. 1) authorizes refunds where the taxpayer has incurred certain types of losses, and provides that claims must be accompanied by "proof to their (Commissioners of Inland Revenue) satisfaction * * * of the payment of tax upon the aggregate amount of income" of the claimant. In dealing with many thousands of claims under this section, dividends form a part of the "aggregate amount of income" in a great majority of cases and have paid no other income tax than that deducted by the corporation before distribution (R. pp. 123-124). The Department of Inland Revenue accepts proof* that income tax has been deducted

* As stated at page 6 hereof the statements of income tax deduction required to accompany dividend warrants constitute such proof.

from a dividend as evidence of payment of income tax by the shareholder-claimant, and refunds vast sums annually to taxpayers whose income tax has been deducted at the source from their dividends (R. pp. 123, 124).

The case is more striking where the taxpayer is an insurance company or a company "whose business consists mainly in the making of investments" referred to in Section 33. If such a Company "has been charged to tax by deduction or otherwise," it may obtain a refund of "so much of *the tax paid by it* as is equal to the amount of the tax on any sums disbursed as expenses of management." This section deals with investment income, and the words "tax paid by it" obviously include tax deducted from dividends received. It is manifest from these sections, and the administrative practice thereunder, that income tax deducted from dividends is income tax paid by the shareholders to the Crown, and that their operation extends to all persons and certain corporations—not merely to "earners of small income." These provisions, it should be noted, afford no relief to those who only bear the final incidence or "ultimate burden" of the tax—the position of the shareholder according to the opinion of the Circuit Court of Appeals in the *Biddle* case. On the contrary, they are limited only to those who have "paid tax" either by way of deduction (as in the case of dividends) or under direct assessment.

The refund practices of the Department of Inland Revenue were explained in detail by the expert witness, who testified, *inter alia* (R. p. 124):

> "In the course of my service as a district inspector, I must have paid out of the National Exchequer many millions of pounds sterling, which could have been paid out properly only if tax deducted from the dividends of the dividend-paying companies was tax paid by the recipients of those dividends."

The Board of Tax Appeals was fully cognizant of the English law and the practice thereunder as shown by the following statement (R. pp. 93, 94):

> "* * * the stockholder receiving the dividend may not, by reason of exemptions and relief provisions of the income tax acts, be required to pay the full amount of the tax represented by the tax 'appropriate' to the dividend. In such case, the stockholder is entitled to file a claim for refund with the English authorities and upon the proof of claim is entitled to recover a part or all of the tax 'appropriate' to the dividend."

Since the shareholder may thus actually recover from the Crown all or a part of the income tax deducted from his dividends, it necessarily follows that he has paid the tax deducted. It is not a non-existent "theoretical amount," as petitioner would have us believe (Petitioner's brief, pp. 20, 27), but tax paid by the shareholders, which is refunded to him. There is nothing theoretical or non-existent about the receipt of a cash refund which a shareholder receives because the tax deducted from his dividends exceed his true liability for income tax.

Petitioner, under Point I (*b*) of his Argument (p. 23) claims that the income tax deducted from respondent's British dividends is not a "tax," and states at page 24 of his brief that "it is not imposed as a tax by legislative authority." This statement flies in the face of the entire testimony of the expert, the provisions of the United Kingdom Income Tax Act and the Finance Acts, and the decisions of the British courts. It lacks foundation or support either in fact or law.

The tax in question is an income tax deducted under the provisions of the general income tax statute; it is measured by the taxpayer's dividend income; it is imposed at the same "standard rate" of income tax applicable to all taxable income and is in the exact amount which the shareholder would be required to pay if he had actually received the entire gross dividend and were subject to a direct assessment; the shareholder is required by statute to submit to it; and under proper circumstances all or a part of it may be recovered by the shareholder *from the Crown* as an over-payment of income tax under the refunding provisions in Part III of the Income Tax Act of 1918, which apply to all income tax however collected or paid.

The British courts have held it to be an income tax on the shareholder's dividend income; *Ashton Gas Co.* v. *The Attorney-General,* [1906] A. C. 10 (R. p. 128); *Brooke* v. *The Commissioners of Inland Revenue,* 7 British Tax Cases 261 (R. p. 195); *Hamilton* v. *The Commissioners of Inland Revenue,* 16

British Tax Cases 213 (R. p. 265); *Samuel* v. *The Commissioners of Inland Revenue,* 7 British Tax Cases 277 (R. p. 289); *Williams* v. *Singer,* 7 British Tax Cases 387 (R. p. 211). These cases are discussed in considerable detail by the expert (R. pp. 118-123, 128, 130).

The British Parliament, as pointed out in our discussion of the refunding provisions above, unquestionably considers it as an income tax paid to the Crown by the shareholder (R. pp. 116-118).

In administering the English law the Revenue officials of the Crown recognize it to be an income tax on the shareholder's dividend income (R. pp. 123-124, 126, 156, 173).

Our courts, including the court below in this case, have held that it is an income tax paid to the Crown by the shareholder; *United Dyewood Corp.* v. *Bowers,* 44 F. (2d) 399, at page 402 (S. D. N. Y.); *United Shoe Machinery Corp.* v. *White,* 89 F. (2d) 363 (C. C. A. 1st); *cf. Robillard* v. *Commissioner,* 20 B. T. A. 685. And finally, the petitioner himself as hitherto recognized its true character both in his published rulings and uniform practice of long standing. S. M. 3040, IV-1 Cumulative Bulletin 198; S. M. 5363, V-1 Cumulative Bulletin 89; I. T. 2401, VII-1 Cumulative Bulletin 126; see also G. C. M. 3179, VII-1 Cumulative Bulletin 240. These rulings have never been modified, amended or revoked since their promulgation and are in effect today.

Petitioner purports to find comfort for his contentions in certain language wrested from decisions of

the British courts,* some of which were not introduced in evidence nor was the expert witness examined with reference thereto. As to those cases upon which the expert testified concerning their true meaning and effect in the light of his long experience and special knowledge, petitioner has ignored all of such testimony and attempted to substitute for it his own individual analysis. This he may not do: *Herbst* v. *S. S. Asiatic Prince,* 108 Fed. 287, at page 289 (C. C. A. 2d), certiorari denied 183 U. S. 697. Petitioner has read these cases without appreciating the distinction between payment of a tax under direct assessment and payment by having tax deducted from income before receipt. The *Neumann* case (Petitioner's brief, pp. 24, 35) has been referred to above and was explained in detail by the expert (R. pp. 149-153). The *Neumann* case involved the following situation: Under the scheme of the English Income Tax Acts, income arising from the ownership of real property is charged with tax upon the basis of the annual value of the property. Although this annual value is required to be determined by reference to the rack-rent at which the property is let or is worth to be let, it commonly happens that for one reason or another there is a difference between the actual rent yielded by a property in a particular year and the amount at which the annual value of that property is assessed for income tax purposes. Salisbury House Estate, Limited, was the rated occupier and owner of a large block of buildings in London, and

* On pages 24, and 33-41 of petitioner's brief.

the business of the Company consisted in the management of the property and the letting out of rooms and suites as unfurnished offices. For the purposes of income tax under Schedule A, annual value of the entire property was assessed in one sum and tax upon this sum was paid year by year by the Company. It appeared, however, that the Company's actual net revenues from the letting and management of its property substantially exceeded the amount of the Schedule A assessment upon the annual value. In an attempt to collect income tax upon this excess, the Crown sought to establish the proposition that the Company was liable not only under Schedule A upon the assessed annual value of its property but also under Schedule D upon the ground that its letting and management of a single block of property constituted the carrying on of a trade and that the excess was taxable as the profit of such trade. This attempt failed, the House of Lords holding that the Schedule A assessment based upon annual value must be taken to constitute the statutory measure of the whole of the taxable income arising from the ownership of real property. As a result, the company was in possession of a certain sum of accumulated profit upon which in actuality no income tax had been paid. For all the purposes of the Income Tax Acts, however, the whole of the Company's profits were regarded as having been duly charged to tax. The Company had created a reserve fund representing the surplus of its accumulated rents over the aggregate amounts of the Schedule A assessment on its prop-

erties; and immediately after having obtained a favorable decision, distributed this reserve fund as a dividend among the shareholders. This dividend was described by the Company as a dividend of "5% actual" and purported to be a distribution of untaxed income which was taxable neither in the hands of the Company nor in the hands of the recipient shareholders. Neumann was one of the shareholders in Salisbury House Estate, Limited, who participated in the distribution and he actually received a sum of £4275. It was not contended by the Crown that any part of this sum was chargeable under direct assessment in the hands of Neumann with income tax at the standard rate. They claimed, however, that the dividend was liable to Sur-tax as a part of Neumann's income and that for such purposes it should be treated as a "free of tax" dividend of £4275. In calculating Neumann's total income for Sur-tax purposes, therefore, they included this dividend at the amount of £5344, that being the gross equivalent of a "free of tax" dividend of £4275. Neumann in his appeal contended primarily that no part of this dividend ought to be treated as his income for Sur-tax purposes, and in the alternative that no more than £4275 was required to be included in his statement of total income. The House of Lords decided that the whole of the dividend had been paid out of income within the meaning of the Income Tax Acts and that surplus above-mentioned did not represent a non-taxable subject-matter but it was a portion of the company's taxable income that

obtained a favorable basis of measurement for income tax purposes. The House of Lords held Neumann's dividends were taxable income from which the deduction was authorized, and, therefore, subject to Sur-tax liability in his hands. The next question was whether Neumann was liable to Sur-tax upon the actual amount of £4275 that he received or upon £5344 on the basis that the £4275 was a "free of tax" dividend. (As, for example, in *Ashton Gas Company* v. *The Attorney-General,* [1906] A. C. 10, and *Samuel* v. *Commissioners of Inland Revenue,* 7 British Tax Cases 277.) Having regard to the peculiar facts of the case and the fact that the company had described the distribution of the surplus above-mentioned as a dividend of "5% actual" the conclusion was reached that the Company had not distributed a "free of tax" dividend. In the light of these considerations, the decision in the *Neumann* case has no bearing whatever upon the present question whether, when a company has deducted income tax from a dividend, either by declaring a gross dividend and specifically deducting tax or by declaring a dividend "free of tax," the recipient shareholders have paid the tax on their dividends. The opinions of the House of Lords contain, however, certain *obiter dicta* upon which it is proper to comment. Lord Wright observed "The shareholder and the company are no doubt separate entities; the company is not an agent for the shareholder to pay tax on the dividend, nor is the company the Collector for the Revenue to deduct the tax from the dividend.

The company is the taxpayer." The conclusion is, that under the provisions of English Income Tax Law the profit of a company is one thing and the dividend of the shareholder is another. The profit is the company's income; the dividend is the shareholder's income. When Lord Wright said: "The Company is the taxpayer" he meant nothing more than this: that a direct assessment of tax is made upon the company and no direct assessment is made upon the shareholder. He is not to be understood to say that the shareholder is not a taxpayer. Similar observations to the effect that dividends, as such, are not taxable under Schedule D (*i. e.*, by direct assessment) were also made by Lord Tomlin (R. p. 327) and Lord Warrington (R. p. 331). It is clear in this instance that they also were thinking merely of liability to direct assessment. Their words are not open to the construction that where shareholders suffer deduction of tax they do not thereby pay the tax. It is interesting to note that since the present case was heard before the Board of Tax Appeals the English courts have held that the Neumann case was "decided on peculiar facts" and that the holding therein had no general application but was to be construed only as applying to those particular facts: *Commissioner of Inland Revenue* v. *Pearson,* [1936] 2 K. B. 533.

Ritson v. *Phillips* (Petitioner's brief, p. 33) is discussed and explained by the expert at page 146 of the Record. *Purdie* v. *Rex* (Petitioner's brief p. 34) was expressly disapproved in *Brooke* v. *The Commissioners of Inland Revenue, supra* (R. p. 195),

and is discussed and explained by the expert at pages 141-144 of the Record. The *Dalgety* case (Petitioner's brief p. 39), to which a substantial portion of cross examination was devoted, involved only the question whether or not the word "paid" in subsection 1 of Section 27, dealing with partial relief from United Kingdom income taxes where Dominion income taxes had been paid, should be construed as limited in its meaning to "tax paid and ultimately borne by the company." The House of Lords decided against that construction. Neither they, nor any inferior court, were asked to passed upon the question whether or not a shareholder has paid income tax by deduction when tax is withheld from his dividend income. It is self-evident, as was pointed out no less than six times by Mr. Talbot during cross examination (R. pp. 158, 159, 166, 167, 168, 172) that this case, involving interest payments, not dividends, and limited to the construction of a specific relief section of the British law, has no bearing upon either the question here presented or any general principle of income tax law. An examination of these cases and the Record references will show that they contain nothing whatever which in any way qualifies or contradicts the overwhelming and unequivocal evidence (both oral and documentary) that when United Kingdom income tax was deducted from respondent's dividends such deduction constituted a payment of income tax by respondent to the Crown.

Petitioner has cited or quotes from certain other British cases which he did not introduce in evidence

and upon which he did not examine the witness. These are *Scottish Union & National Life Ins. Co.* v. *New Zealand & Australian Land Co.,* [1921] 1 A. C. 172; *Sheldrick* v. *South African Breweries, Ltd.* [1923] 1 K. B. 173 (Petitioner's brief p. 35); *Bradbury* v. *English Sewing Cotton Co.,* [1923] A. C. 744, 8 British Tax Cases 481 (Petitioner's brief page 35); *Commissioners of Inland Revenue* v. *Blott,* 8 British Tax Cases 101 (Petitioner's brief p. 37). Although none of these cases has any real bearing upon the point at issue here, brief abstracts of each and comments thereon are set forth in the Appendix attached hereto for the convenience of the Court.

Without further discussion of the British law we submit that when the entire Record is read and the British system of administering their income tax law is understood, the petitioner must fail in his attempt to build a case by wresting from its context certain testimony of the expert and certain isolated language in British court opinions.

II.

THE COURT BELOW CORRECTLY HELD THAT PETITIONER WAS BOUND BY HIS PUBLISHED RULINGS AND UNIFORM PRACTICE OF OVER FIFTEEN YEARS' STANDING.

It has been and is our contention that Mr. Talbot's testimony in this case confirms the analysis of the British law appearing in S. M. 5363, V-1 Cumulative

Bulletin 89. We have nowhere intimated or even suggested that we do not rely upon the reasoning, as petitioner would have this Court believe. In S. M. 5363 the Commissioner recognized that the English Income Tax laws were grounded upon the principle of collecting tax by deduction at the source, that the intention of Parliament was that a British company should not be left to bear tax upon its profits distributed in the form of dividends, and that such dividends should be taxed to the shareholder by the process of deduction at the source. In this ruling the Commissioner held that:

> "The entire income tax paid by a British corporation to the British Government for a given year on its gains and profits may or may not be borne by the corporation. The tax which it bears is the tax directly assessed against it on its gains and profits plus any tax withheld from income received by the corporation during the year, less (*a*) the tax deducted and retained on annual charges on profits reported for tax and (*b*) the tax on the profits distributed as dividends.
>
> "*The tax deducted from profits distributed as dividends is a tax against the shareholder.* The tax deducted from interest payments or annual charges is a tax against the recipient of the interest or other annual payments. The tax on the profits which are retained by the corporation is a tax against the corporation." (Italics ours.)

This ruling, and the reasoning contained therein, do not conflict with the evidence of the British law appearing in the present Record.

A uniform construction and interpretation of a statute adhered to for over fifteen years in actual practice by those called upon to administer that statute is entitled to the greatest weight: *McFeely* v. *Commissioner,* 296 U. S. 102, 109-110; *Burnet* v. *S. & L. Building Corp.,* 288 U. S. 406, 415, 866; *McCaughn* v. *Hershey Chocolate Co.,* 283 U. S. 488, 492; *Fawcus Machine Co.* v. *United States,* 282 U. S. 375, 378; *Universal Battery Co.* v. *United States,* 281 U. S. 580, 583; *Brewster* v. *Gage,* 280 U. S. 327, 336.*

The rationale of this principle is expressed in the opinion of this Court in *United States* v. *Midwest Oil Co.,* 236 U. S. 459, 472-473.

> "It may be argued that while these facts and rulings prove a usage, they do not establish its validity. But government is a practical affair, intended for practical men. Both officers, lawmakers, and citizens naturally adjust themselves to any long-continued action of the Executive Department, on the presumption that unauthorized acts would not have been allowed to be so often repeated as to crystallize into a regular practice. That presumption is not reasoning in a circle, but the basis of a wise and quieting rule that, in determining the meaning of a statute or the existence of a power, weight shall be given to the usage itself,—even when the validity of the practice is the subject of investigation."

* In the *Universal Battery Co.* case this Court said:

"This construction of those terms has been adhered to in the Internal Revenue Bureau for about ten years, and it ought not to be disturbed now unless it be plainly wrong. We think it is not so, but is an admissible construction."

Each of the Revenue Acts from 1918 through the Revenue Act of 1928 has re-enacted the foreign tax credit provisions without change. Congress must be taken to have been familiar with the administrative interpretation embodied in published Internal Revenue Bureau rulings, and to have adopted and approved such interpretation and administrative practice when it subsequently re-enacted the statute without change: *McFeely* v. *Commissioner, supra; Helvering* v. *Bliss,* 293 U. S. 144, 151; *United States* v. *Dakota-Montana Oil Co.,* 288 U. S. 459, 466; *Massachusetts Mutual Life Insurance Co.* v. *United States,* 288 U. S. 269, 273; *Cook* v. *United States,* 288 U. S. 102, 120; *McCaughn* v. *Hershey Chocolate Co., supra; National Lead Co.* v. *United States,* 252 U. S. 140, 146-147; *United States* v. *Cerecedo Hermanos y Compania,* 209 U. S. 337, 339.

Petitioner has adopted the statement of the Circuit Court of Appeals for the Second Circuit in the *Biddle* case, that "the clauses of the Revenue Act allowing credit and deductions for taxes paid to a foreign country * * * are clear without departmental interpretation." This observation is clearly not consistent with reality when consideration is taken of the substantial number of Bureau rulings which have been necessary to interpret these provisions and the volume of litigation involving their application. Indeed, the present case comes before this Court only because of a conflict of Circuits upon the credit question, the Circuit Court of Appeals for the First Circuit and the court below having confirmed the original construction set forth in the Commissioner's rulings and applied in practice by him for over fifteen

years, while the Circuit Court of Appeals for the Second Circuit permitted him to change his position.

Our position has been well stated by the court below (R. p. 391).*

The entire legislative history of the credit provisions with their gradual expansion to take in new situations discloses a congressional intention or desire to eliminate the burden of international double taxation, and this Court has held that they should be given such construction as will effectuate that purpose: *Burnet* v. *Chicago Portrait Co.*, 285 U. S. 1, 7. This purpose has been recognized by the Commissioner up to the time of his present change of position.

If there should now be any reasonable doubt as to the allowance of the credit claimed by respondent—and we submit that there should be no such doubt on this Record—it should be resolved most favorably to the taxpayer and the credit allowed: *White* v. *Aron-*

* "First, if there is any doubt as to the construction of a taxing statute—and this cannot be ignored—such doubt is resolved in favor of the taxpayer. *McFeely* v. *Commissioner*, 296 U. S. 102, 56 S. Ct. 54; *Boca Ratone Co.* v. *Commissioner*, 86 F. (2d) 9; *Crowe* v. *Commissioner*, 86 F. (2d) 796; *Pinkney Packing Co.* v. *Thomas*, 17 F. Supp. 420. Next, the provision we are called upon to interpret is a relief provision intended for the benefit of the taxpayer and such construction should be given as will effectuate that purpose. See *Burnet* v. *Chicago Portrait Co.*, 285 U. S. 1, 52 S. Ct. 275; *United States* v. *Updike*, 281 U. S. 489; *Dauphin Trust* v. *United States*, 80 F. (2d) 893, 896; Commissioner *v.* Bryson, 79 F. (2d) 397, 402. Finally, the rulings and practice of the Bureau of Internal Revenue since 1918 to 1933, S. M. 3040, C. B. IV-1, p. 198; S. M. 5363, C. B. V-1, p. 89; I. T. 2401, C. B. VII-1, p. 128, granting deductions and credits, plus the congressional reenactment of the statutes, have led to people making their investments and give the rulings persuasive force and should not be disregarded by the courts. *McFeely* v. *Commissioner, supra; Morrissey* v. *Commissioner*, 296 U. S. 344, 56 S. Ct. 289; *Woolworth* v. *United States*, 15 F. Supp. 679, 684; Cf. *United Shoe Machinery Corp.* v. *White*, 13 F. Supp. 97, 101. Congress has reenacted this provision in the Revenue Acts presumably knowing that the department was treating deductions by the British companies as income tax 'appropriate to' the dividends of the shareholder. Beyond the purpose of the taxing authorities to exact more from taxpayers, there is no logical reason to reverse this ruling of many years which has the sanction of Congress."

son, decided by this Court November 8, 1937, No. 20, present Term.

Fifteen years of uninterrupted uniform practice by the administrative department, approved by Congress without change in successive Revenue Acts, must not be ignored, particularly where, as here, it is shown that such practice was correct.

III.

CONCLUSION

In conclusion, it is submitted that a reading of the entire Record conclusively shows that the $7,017.11 deducted at the source from the gross amount of respondent's British dividend income during 1931 was income tax paid to a foreign country for which credit must be allowed pursuant to Section 131 of the Revenue Act of 1928, and that the judgment of the court below should therefore be affirmed.

Respectfully submitted,

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APPENDIX.

CASES RELIED UPON BY PETITIONER WHICH WERE NOT INTRODUCED IN EVIDENCE AND UPON WHICH THE EXPERT WAS NOT EXAMINED.

Scottish Union and National Ins. Co. v. *New Zealand and Australian Land Co., Ltd.*, [1921] 1 A. C. 172.

The Land Co. paid United Kingdom income tax at the full rate of 5*s.*, and thereafter obtained a refund of 1*s.* 6*d.* on account of Dominion income taxes paid to Australia, pursuant to Section 43 of the Finance Act of 1916. In declaring and paying a preference dividend limited to 4% to the Insurance Co., the Land Co. deducted United Kingdom income tax at the full rate of 5*s.* The Insurance Co. contended that only the net United Kingdom tax as reduced by Dominion relief should have been deducted from its dividends, relying on *Rover* v. *South African Breweries, Ltd.*, [1918] 2 Ch. 233.

The House of Lords overruled the *Rover* case, pointing out (1) that Dominion income tax was a company business expense which reduced the sum available for dividends, (2) that Dominion tax had been paid by the company, (3) that although United Kingdom tax had been paid by them, no Dominion tax had been paid by the shareholders, and (4) that the relief from double taxation was limited under the Finance Act then in effect to the person who paid the Dominion tax.

The only question involved was the proper construction of the relief section, but Viscount Finley, at page 181, recognized the respondent's position in the case now before this Court, *i. e.,* that there are two taxpayers and that *the shareholders paid United Kingdom income tax when it was deducted from their dividends,* saying:

> "The preference stockholders have paid by deduction the United Kingdom tax, but they did not pay the Colonial tax."

[A few days after this case was decided the Finance Act of 1920 was passed, Section 27(5) of which nullified the holding in this case by restoring the rule in the *Rover* case providing that only the net United Kingdom tax (as reduced by Dominion relief) could be deducted from dividends. This is discussed at length in *Sheldrick* v. *South African Breweries, Ltd.,* [1923] 1 K. B. 173, at pages 185, 192-194.]

Sheldrick v. *South African Breweries, Ltd.,* [1923] 1 K. B. 173.

The Brewery Co. paid tax on its profits (1) to the Union of South Africa on its Dominion income, and (2) to the United Kingdom on all of its income. Sheldrick was a preferred shareholder from whose dividends the company deducted United Kingdom tax at the full rate of 6*s*. He brought suit contending that under Section 27(5) of the Finance Act of 1920 the deduction was required to be made at the net United Kingdom rate (as reduced by Dominion relief) or 4*s*. The Company relied on the *Scottish Union* case.

It was held in favor of Sheldrick that Section 27(5) nullified the *Scottish Union* case and restored the rule in the *Rover* case, under which deduction of income from "any dividends" (including preferred) was limited to the net United Kingdom rate as reduced by Dominion relief obtained by the Company even though the shareholder had not directly paid Dominion tax.

[Petitioner here relies on certain historical language in this case dealing with the then obsolete Section 43 of the Finance Act of 1916. The quotation is misleading because it is separated from the context and no explanation of Section 43 is given. The opinions in this very case show that this section was superseded by Section 27 of the Finance Act of 1920, subsection 5 of which granted Dominion relief to the shareholders, directly contrary to the isolated language quoted by petitioner.]

Bradbury v. *English Sewing Cotton Co., Ltd.*, [1923] A. C. 744.

The English parent company owned all the shares of an American subsidiary company upon which it received dividends during the years 1914 through 1919. Prior to 1917 the American subsidiary was "resident" in England and subject to United Kingdom income tax, and during this period the English parent was made to pay income tax on its dividends by submitting *ex necessitate* to deduction of tax at the source. In 1917 the American company withdrew

from England and was thus no longer subject to the United Kingdom Income Tax Acts. Therefore, subsequent dividends were paid to the English company in their "gross" amount, and subject to income tax as foreign income under Schedule D. The Crown, in an attempt to get additional tax, claimed that in computing the English company's income tax on a three year average the dividends before 1917, from which income tax had already been deducted at the source, should be included.

The House of Lords held that dividend income from the American subsidiary while it was "resident" in England, which income had already been taxed at the source by deduction, should not be included and was not subject to "assessment."

The Lord Chancellor points out at page 752 that the dividends received by the English company prior to 1917 *"have already paid tax by deduction, and could not now be taxed again,"* nor could they be included in the average for later years. (Italics ours.)

[This language of the Lord Chancellor squarely sustains and confirms the evidence in the present case. The *Bradbury* case is important here also in so far as it illustrates the distinction between payment of income tax by deduction (as was done on resident dividends prior to 1917), and payment under direct assessment under Schedule D (as was done on foreign dividends for 1917 and later years).]

Commissioners of Inland Revenue v. *Blott*, [1921] 2 A. C. 171, 8 British Tax Cases 101.

During the course of his opinion in this case Viscount Cave made the observation that the company did not pay income tax "on behalf of its shareholders," and that "no agency, properly so-called, is involved" where a company pays income tax upon its own profits.

The sole question involved was whether stock dividends were liable to Super-tax under Section 66 of the Finance Act of 1909-10 (10 Edw. VII, c. 8). The Crown urged as a make-weight that the company had paid income tax on that part of the capitalized profits represented by the stock dividends "on behalf of the shareholder," that such dividends had been subjected to income tax and were consequently subject to additional income tax or Super-tax. The case, however, was decided in conformity with the reasoning in *Eisner v. Macomber,* 252 U. S. 189, upon which some reliance was placed. The decision can, in no way, be taken to mean that a shareholder pays no income tax upon cash dividends, upon that tax is deducted at the "standard rate." Viscount Haldane observed at page 180:

> "My lords, there is no doubt that the money in question [the capitalized surplus] formed originally part of the profits made by the company on which it was liable to pay income tax. It is quite another question whether these profits as such ever reached the respondent and the other shareholders as income so as to make them liable for income tax and entitled to a deduction on the score that the tax had already been paid by the company."